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In The Supreme Court of the United States

MARTIN P. SHEEHAN,
Trustee for the Bankruptcy Estate of T & T Fuels, Inc.
and Sheehan & Nugent, P.L.L.C. and
Phillips, Gardill, Kaiser & Altmeyer, PLLC,

Petitioners,

v.

WEST VIRGINIA DEPARTMENT OF
ENVIRONMENTAL PROTECTION,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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10 pp

QUESTIONS PRESENTED FOR REVIEW

1. Did the States surrender their sovereignty over bankruptcy proceedings as part of the plan of the constitutional convention so that Congress had power resulting from the "uniform law" provisions of Article I, Section 8, Clause 4 of the Constitution to enact 11 U.S.C. § 106 and abrogate the opportunity for States to claim the protection of the Eleventh Amendment in the Bankruptcy Courts?

2. Assuming a State is entitled to assert the Eleventh Amendment in Bankruptcy Court proceedings, does the litigation conduct of the State in seeking and accepting the benefits of the activities of a bankruptcy trustee and his counsel constitute a waiver, under the common benefit doctrine, of the Eleventh Amendment sufficient to require the State to accept financial responsibility for administrative expenses incurred by the trustee and his counsel?

PARTIES TO THE LITIGATION

The petitioners are the bankruptcy trustee, Martin P. Sheehan, and two law firms employed by him, Sheehan & Nugent, P.L.L.C. and Phillips, Gardill, Kaiser & Altmeyer, PLLC. The respondent is the West Virginia Department of Environmental Protection. The Assistant United States Trustee for West Virginia has had authority to appear and be heard on any issue in this bankruptcy case pursuant to 11 U.S.C. § 307. The Assistant United States Trustee has taken no role in any stage of the instant controversy.

Neither Sheehan & Nugent, P.L.L.C. nor Phillips, Gardill, Kaiser & Altmeyer, P.L.L.C. has a parent company nor is the stock in either of these entities held by any publicly traded corporation.

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OPINIONS AND ORDERS BELOW

The written opinion of the United States Court of Appeals for the Fourth Circuit in this matter was entered on January 9, 2003 (App. 1-9) The Order of the U.S. District Court for the Northern District of West Virginia was entered December 12, 2001 (App. 10-28). The Order of the United States Bankruptcy Court for the Northern District of West Virginia was entered August 21, 2000. (App. 29-36) All are unpublished.

STATEMENT OF JURISDICTION

The written opinion of the United States Court of Appeals for the Fourth Circuit in this matter was issued on January 9, 2003. This Court has jurisdiction to grant a petition for a writ of certiorari to review a decision of the United States Court of Appeals for the Fourth Circuit pursuant to 28 U.S.C. § 1254.

The Assistant United States Trustee for West Virginia, an appointee of the Attorney General pursuant to 28 U.S.C. § 582, has had the right to appear in this matter and be heard pursuant to 11 U.S.C. § 307, but has not done so. It appears that no separate certification under 28 U.S.C. § 2403 has been necessary.

CONSTITUTIONAL AND STATUTORY PROVISIONS AT ISSUE

1. Article I, Section 8, Clause 4 of the Constitution of the United States

The Congress shall have power . . . To establish an uniform Rule of Naturalization and uniform Laws on the Subject of Bankruptcies throughout the United States;

2. Eleventh Amendment to the Constitution of the United States

The Judicial Power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

3. 11 U.S.C. § 106

(a)(1) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following: 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 522, 523, 524, 525, 542, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 725, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.

(2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.

(3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages. Such order or judgment for costs or fees under this title or the Federal Rules of Bankruptcy Procedure against any governmental unit shall be consistent with the provisions and limitations of section 2412(d)(2)(A) of title 28.

(4) The enforcement of any such order, process, or judgment against any governmental unit shall be consistent with appropriate nonbankruptcy law applicable to such governmental unit and, in the case of a money judgment against the United States, shall be paid as if it is a judgment rendered by a district court of the United States.

(5) Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.

(b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

(c) Notwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

4. 11 U.S.C. § 101(27)

In this title . . .(27) "governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency or instrumentality of the United States (but not a United States Trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.

STATEMENT OF THE CASE

In 1995, T & T Fuels, Inc. filed for bankruptcy in the United States Bankruptcy Court for the Northern District of West Virginia. Martin P. Sheehan, petitioner, was appointed as trustee. While T & T Fuels, Inc. listed some equipment on its bankruptcy schedules, it appeared that most of the assets were encumbered by secured liens. There were no liquid assets.

T & T Fuels, Inc. had previously operated coal mines in West Virginia. While the coal mining had ceased, the mines remained an active source of acid mine drainage. Whenever it would rain, water would seep into the mines and react with the air and minerals in the mines. As the mines filled, gravity would cause polluted water to drain from the mine untreated.

Without assets, and with obligations to treat polluted water, Sheehan threatened to resign as trustee unless given personal immunity by the State and Federal governments for the discharge of acid mine drainage beyond his control. The relevant government agencies agreed to this request. Thereafter, the West Virginia Department of Environmental Protection (hereinafter the DEP) assumed the day to day management of the closed mine sites. In doing so, DEP assumed the position that it was fulfilling the duties of T & T Fuels, Inc. under relevant environmental statutes and regulations, and made clear it would seek to be reimbursed by the Bankruptcy Estate of T & T Fuels, Inc. for its efforts.

Sheehan proceeded to liquidate the tangible assets of T & T Fuels, Inc. not necessary for water treatment. In addition, he employed counsel (the co-petitioners) on a contingent fee basis, to pursue claims against the principals of T & T Fuels, Inc, and several related corporations for breach of fiduciary duty and disguised fraudulent transfers of assets.

DEP filed a proof of claim. DEP was then entitled to insist that the trustee exercise his fiduciary obligations for the benefit of DEP as well as other creditors. In the proof of claim, DEP sought in excess of 36 million dollars to permanently correct water pollution problems. After extensive hearings, the Bankruptcy Court allowed the claim, as an unsecured claim in the amount of approximately 6.7 million dollars. DEP appealed to the District Court claiming that the amount was inadequate, and accorded an incorrect priority.

Meanwhile, attorneys for Sheehan (the co-petitioners) continued to make substantial efforts to develop the case against the principals in T & T Fuels, Inc. The trustee filed a motion for summary judgment seeking a judgment adequate to pay all creditors, including the 6.7 million dollar claim allowed to DEP. Although that motion was denied, the suit against the principals was scheduled for trial.

One of the principals, Paul Thomas, opened negotiations to make restitution to DEP as part of a plea of guilty to criminal violations of the Clean Water Act in the United States District Court for the Northern District of West Virginia. At hearings in that forum,

Mr. Thomas and DEP agreed it was their collective desire to maximize the recovery by DEP by not paying the trustee or his counsel. DEP indicated if a direct deal could not be reached, it would rely upon the trustees efforts and seek to recover from the bankruptcy estate. Making a separate agreement was contrary to a series of representations made by DEP to the trustee and his counsel (the co-petitioners) during the pendency of the bankruptcy case.

Despite the representations made to Sheehan, DEP concluded a restitution agreement with Mr. Thomas. One of the conditions of the restitution agreement was that DEP would withdraw its proof of claim in Bankruptcy Court. This substantially reduced the size of the damage claim the trustee was making against the principals.[1] Sheehan then concluded a separate agreement with the principals. However even in so doing Sheehan protected DEP. Specifically the agreement between Sheehan and the principals of T & T was made conditional on withdrawal of the DEP proof of claim. Sheehan included such a provision because DEP had not actually withdrawn its proof of claim and relieved Sheehan of his fiduciary duties to DEP.

Sheehan prepared a distribution report, and convinced his counsel to reduce the amount they sought as fees to guarantee a recovery by unsecured creditors of fifty per cent. Meanwhile a separate motion

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1 Because the principals were, through several corporations, the shareholders, the upper limit on damages could not exceed an amount necessary to pay creditor claims. Any greater amount would be paid back to the persons being sued.

was filed by the trustee on behalf of his counsel (the co-petitioners) seeking a quantum meruit attorneys' fee from DEP. The Bankruptcy Court sua sponte raised the Eleventh Amendment as a threshold matter. After briefing, the Bankruptcy Court held that the Eleventh Amendment was an impediment to an award of attorneys' fees. However, the Bankruptcy Court did recognize that DEP had a moral obligation to pay the trustee and his counsel (the co-petitioners) for work which in fact had benefited DEP.

On appeal, the District Court agreed their Eleventh Amendment created a bar to the award of quantum meruit fees that had been earned and affirmed the Bankruptcy Court. The Court of Appeals for the Fourth Circuit affirmed also.

Basis For Jurisdiction Below

The Court of Appeals for the Fourth Circuit had jurisdiction of an appeal from a final order of the United States District Court pursuant to 28 U.S.C. 158(d). The United States District Court for the Northern District of West Virginia had jurisdiction pursuant to 28 U.S.C. § 158 and § 1334. Pursuant to 28 U.S.C. § 157 jurisdiction was initially exercised by the United States Bankruptcy Court for the Northern District of West Virginia.

ARGUMENT FOR ALLOWANCE OF THE WRIT

I. THE PLAN OF CONVENTION

In Seminole Tribe of Florida v. Florida, 517 U.S. 44 (1996) this Court held that Congress lacked power under the Indian Commerce Clause in Article I, Section 8, clause 3 of the Constitution to abrogate the prohibition against private parties suing States in federal court that is the essence of the protection in the Eleventh Amendment. In that case, the Court suggested that no power in Article I, section 8 existed which would be adequate to permit a private party to sue a non-consenting State. This view of Seminole Tribe has also been expressed in Florida Prepaid Post Secondary Education Expense Board v. College Savings Bank, 527 U.S. 627, 636 (1999); College Savings Bank v. Florida Prepaid Post Secondary Education Expense Board, 527 U.S. 666, 672 (1999); Kimel v. Florida Board of Regents, 528 U.S. 62, 78 (2000); Board of Trustees of University of Alabama v. Garrett, 531 U.S. 356, 364 (2001); and, Federal Maritime Commission v. South Carolina State Ports Authority, __ U.S. __ , 122 S. Ct. 1864, 1878-79 (2002).

Still this Court has never addressed whether the specific power ceded to Congress under the Bankruptcy Clause in Article I, Section 8, clause 4 would permit Congress to require non-consenting States to be bound in bankruptcy matters initiated by private parties. The general discussion of the limits of congressional power under Article I, Section 8 is of only limited usefulness when evaluating the

Bankruptcy Clause[2] for three reasons. First, unlike the other powers granted to Congress, the Bankruptcy Clause gave Congress the power to enact "uniform laws on the subject of Bankruptcies." Second, bankruptcy law would inevitably involve some adjudication by a tribunal of whether a person met the standards established for bankrupts and decision-making about the adjustment of debts as well as the proper distribution of assets. Thirdly, the unique phrasing of the Bankruptcy Clause, requiring uniform laws, has been explained as crucial in understanding the cession of State sovereignty in The Federalist, No. 32, in connection with similar language in the Naturalization clause. Collectively, these reasons have led to a division in the United States Courts of Appeals, and other lower federal courts, on whether Congress possessed the power to permit private parties to seek adjudications against non-consenting States in bankruptcy cases.

The United States Court of Appeals for the Sixth Circuit recently held in Hood v.Tennessee Student Assistance Corp. (In re: Hood), 319 F.3d 755(6th Cir. 2003) that Congress had the power under the Bankruptcy Clause to abrogate sovereign immunity. Other cases which reached similar conclusions are In re: Bliemeister, 251 B.R. 383 (Bankr. D. Ariz. 2000) aff'd on alternate grounds 296 F.3d 858 (9th Cir. 2002); In re: Nelson, 254 B.R. 436 (Bankr. W.D. Wis. 2000) rev'd

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2 "[B]ankruptcy has long been considered a special area of the law and the Supreme Court's June 1999 rulings on sovereign immunity have not resolved how far Congressional power extends in the bankruptcy context." Rose v. United States (In re: Rose), 187 F.3d 926, 930 n.1 (8th Cir. 1999).

Nelson v. LaCrosse County Ditrict Attorney (State of Wisconsin), 301 F.3d 820 (7th Cir. 2002).

The essence of the reasoning in Hood is that the inclusion of a uniformity requirement in the Bankruptcy Clause reflected a studied waiver of sovereignty by the States over bankruptcy law issues as part of the original plan of convention.[3] Support for this notion begins with The Federalist, No. 81, relied upon repeatedly by this Court as describing the role of the federal courts in the scheme of the Constitution. While The Federalist, No. 81, recognizes limits on the power of the federal courts over the States, it also acknowledges that other aspects of state sovereignty were discussed in other portions of The Federalist.[4] [This is understood as a cross-reference to The

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3 " [Eleventh Amendment] immunity is one the States enjoy save where there has been 'a surrender of this immunity in the plan of convention' Principality of Monaco v. Mississippi, 292 U.S. 323 (1934)(quoting The Federalist No. 81)" Idaho v. Coeur d'Alene Tribe of Idaho, 521 U.S. 261, 268 (1997)

4 In Principality of Monaco v. Mississippi, 292 U.S. 313, 324 (1934) this Court recounted that;

Hamilton, in the Federalist, No. 81, made the following emphatic statement of the general principals of immunity:

"It is inherent in the nature of sovereignty not to be amenable to the suit of an individual without its consent. This is the general sense and the general practice of mankind; and the exemption as one of the attributes of sovereignty, is now enjoyed by the government of every State in the Union. Unless, therefore, there is a surrender to this immunity in the plan of convention, it will remain with the States, and the danger intimated must be merely ideal. The circumstances which are necessary to produce an alienation of State sovereignty were discussed in considering the article on taxation and need not be repeated here."

Federalist, No. 32.] In that document, there is an express discussion of the surrender of sovereignty by the States over naturalization, the other power in Article I, Section 8, clause 4. The naturalization power is the only other specific power subject to a uniformity requirement in Article I, Section 8. In The Federalist No. 32, Hamilton explained that there had been a complete cession of sovereignty by the States over naturalization matters as was made clear by the use of a uniform law requirement.

The Court of Appeals for the Sixth Circuit also recognized that the purpose of the Eleventh Amendment was not to change the understanding of the judicial power over the States as reflected in Federalist Paper No. 81. Instead the adoption of the Eleventh Amendment was recognized as restoring the general understanding of that power at the time of the adoption of the Constitution. Restoration of the limits on federal power was necessary because the original view, described in The Federalist, No. 81, had been frustrated by the decision in Chisolm v. Georgia, 2 U.S.(2 Dall) 419 (1793). Restoration of the plan of convention has repeatedly been recognized as the purpose of the Eleventh Amendment. See e.g., Alden v. Maine, 527 U.S. 706 (1999).

The Hood court found that there was a surrender of sovereignty over naturalization and bankruptcy in the plan of convention, and found that the Eleventh Amendment had not been enacted to upset the original plan of the convention, but rather to restore the original plan. The Court of Appeals for the Sixth Circuit then concluded that neither the Eleventh

Amendment, nor the principles behind it, limited congressional power under the Bankruptcy Clause to resolve issues involving the States. The Hood court held the States had waived sovereign immunity over bankruptcy matters as part of the waiver of sovereignty in the original plan of convention.

This ruling obviates a number of difficulties that would occur in the administration of current bankruptcy legislation should States be immune from the effect of bankruptcy proceedings. For example, could States claim immunity from the automatic stay and seize assets to satisfy obligations to a State? Or, could States claim a discharge in bankruptcy is ineffective against a State? Or, even if a general discharge is effective, could a State claim immunity from proceedings to obtain a discharge from an obligation owed to a State when additional procedural steps are required, such as institution of proceedings to discharge a student loan as part of an effort to discharge a student loan? Or, can a State be required to return estate assets it has seized or been paid? Or, can a State impose a sanction such as loss of license on those who fail to pay certain debts?[5] See Klee, K.N., Johnston, J.O., Winston, E., State Defiance of Bankruptcy Law, 52 Vanderbilt Law Review 1528 (1999); Browning, M., Tough Bankruptcy Issues Under the Eleventh Amendment, 7 Journal of Bankruptcy Law and Practice 219 (1998); Gebbia-Pinetti, K.M., State Sovereign Immunity and the Bankruptcy Code [Part One] 7 Journal of Bankruptcy Law and Practice 521 (1998); and, Gebbia-Pinetti, K.M., State Sovereign Immunity

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5 This Court held that was not possible in Perez v. Campbell, 402 U.S. 637 (1971).

and the Bankruptcy Code [Part Two], 8 Journal of Bankruptcy Law and Practice 3 (1998)

In contrast, the United States Court of Appeals for the Seventh Circuit has rejected the claim that Congress had any qualitatively different power under the Bankruptcy Clause than elsewhere in Article I, Section 8. See, Nelson v. LaCrosse County Ditrict Attorney (State of Wisconsin), 301 F.3d 820 (7th Cir. 2002). It refused to consider the plan of convention argument, later accepted in Hood Instead, the Nelson court found that this Court's decision in Seminole Tribe and its progeny precluded any evaluation of whether the uniformity requirement of the Bankruptcy Clause and the relevant provisions of The Federalist required a different analysis. In the instant case, the plan of convention argument was raised by petitioners and the Court of Appeals for the Fourth Circuit declined to address the argument (see slip opinion at page App. vii). The Court of Appeals held it was bound by the prior panel decision in Schlossberg v. Maryland (In re: Creative Goldsmith of Washington, D.C., Inc.), 119 F.3d 1140 (4th Cir. 1997) cert. denied 523 U.S. 1075 (1998) finding that 11 U.S.C § 106(a) was unconstitutional, even though that decision did not address the plan of convention issue argument.

Other Courts of Appeals have also held that 11 U.S.C. § 106 is unconstitutional without specific analysis of the plan of convention argument. See e.g., Mitchell v. Franchise Tax Board (In re: Mitchell), 209 F.3d 1111 (9th Cir. 2000); Sacred Heart Hosp. of Norristown v. Pennsylvania (In re: Sacred Heart Hospital of Norristown), 133 F.3d 237 (3rd Cir. 1998);

and Fernandez v. PNL Asset Management Co. LLC (In re: Fernandez), 123 F.3d 241 (5th Cir.) amended by 130 F.3d 1138 (5th Cir. 1997)(rejecting the importance of the uniform law provision without addressing the plan of convention issue).

WHEREFORE petitioner suggests that the petition for certiorari should be granted because there is now an important issue concerning the jurisdiction of the federal courts over States in bankruptcy proceedings in the face of claims by States of immunity from jurisdiction under the Eleventh Amendment to the Constitution and several of the Courts of Appeals have considered this issue, and there is now a conflict in those decisions.

II. WAIVER

This Court has long held that a State can waive the protection of the Eleventh Amendment by its litigation conduct. In the seminal case of Clark v. Barnard, 108 U.S. 436 (1883), the Court held that where a state intervened in a proceeding and claimed a fund that had been paid into court, the State had "become a party to the litigation to the full extent required for its complete determination." Id. at 448. The notion of waiver by "litigation conduct" continued to be recognized in Gunter v. Atlantic Coast Line Railroad Co., 200 U.S. 273 (1906) and Gardner v. New Jersey, 329 U.S. 565 (1947). Last term, the principle of waiver by litigation conduct was again recognized in Lapides v. Board of Regents of the University System of Georgia, __ U.S. __, 122 S. Ct. 1640 (2002).

The principle behind a litigation conduct waiver is that by some affirmative involvement in litigation, a State's decision to resolve a controversy in a federal forum has been made manifest. Consequently, it "cannot escape the result of its own voluntary act by invoking the protection of the Eleventh Amendment." Id. at ___, 122 S. Ct. at 1644 (quoting Gunter). The Lapides case actually held that the removal of a suit against a State by the State to a federal forum was a clear example of litigation conduct that could only be construed as a waiver of the Eleventh Amendment. Obviously, it did not hold, nor has it been understood to have held, that removal was the only example of litigation conduct that might support a waiver.

The United States Court of Appeals for the Fourth Circuit has held that another clear example of waiver by litigation conduct is the mandatory counter-claim rule. See Schlossberg v. Maryland (In re: Creative Goldsmith of Washington, D.C., Inc), 119 F.3d 1140 (4th Cir. 1997) cert. denied 523, U.S. 1025 (1998). The essence of the mandatory counter-claim rule is that when a State initiates action in federal court, as a plaintiff, it must have agreed to resolve the entire controversy between the parties that was placed at issue by the plaintiff-State. This notion is widely recognized in the bankruptcy context although its exact scope is subject to different linguistic formulations. In Schlossberg, which involved an adversary proceeding, the Court focused on the details of Federal Rule of Civil Procedure 13(a) made applicable to such proceedings by Bankruptcy Rule of Procedure 7013. The Court held that the filing of a proof of claim by the Maryland agency responsible for tax collection for unpaid sales

taxes and withholding taxes were said not to arise out of the same transaction involving the preferential payment of corporate income taxes that the trustee sought to recover.

This Court of Appeals for the Tenth Circuit in Wyoming Department of Transportation v. Straight (In re: Straight), 143 F.3d 1387 (10th Cir. 1998) applied waiver principles more loosely. It held that where two state agencies had filed a proof of claim for unpaid taxes, the subsequent suspension of the debtor from a Disadvantaged Business Enterprise program by a third state agency for non-payment of those taxes the action of all the agencies was the action of a single entity, the State. The proofs of claim were sufficient connected to the violation of the automatic stay to permit the Bankruptcy Court to require the State to honor the automatic stay issued pursuant to 11 U.S.C. § 362. The award of attorneys' fees necessary to enforce the automatic stay was sustained.

In State of Georgia Department of Revenue v. Burke (In re: Burke), 146 F.3d 1313 (11th Cir. 1998) the State file a proof of claim to collect particular taxes and the taxes were determined to be entitled to treatment as unsecured debt. Thereafter, the State ignored the discharge injunction issued by the bankruptcy court. The State was found liable for attorneys' fees incurred

in enforcing the automatic stay and the discharge injunction.[6]

In Rose v. United States Department of Education (In re: Rose), 187 F.3d 926 (8th Cir. 1999) the Court of Appeals for the Eighth Circuit found a waiver was supported where the debtor filed for bankruptcy. The State then filed a proof of claim to collect on a student loan. The debtor then initiated an adversary proceeding to declare the student loan debt dischargeable under the undue hardship provisions of 11 U.S.C. § 523. The State asserted Eleventh Amendment immunity from suit in the adversary proceeding. Speaking of the scope of the waiver, the Court wrote, "waiver in one aspect may be sufficiently intertwined so that a waiver in one aspect applies to others as well." Id. at 929. The Court found the filing of the proof of claim was sufficient to permit adjudication of the student loan debt in the dichargeability proceeding.

In Schulman v. State of California (In re: Lazar), 237 F.3d 967 (9th Cir. 2001) cert. denied, __ U.S. __, 122 S. Ct. 458 (2001) the Court of Appeals for the Ninth Circuit noted that no consensus had been reached on the proper scope of waiver of the Eleventh Amendment when a State had filed a proof of claim. Id. at 978.

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[6] In a highly similar case, Dekalb County Division of Family and Children v. Platter (In re: Platter), 140 F.3d 676 (1998) the Court of Appeals for the Seventh Circuit found that by initiating an adversary proceeding to determine a debt to be non-dischargeable, the state agency had acted as a plaintiff and would be bound by the decision of the bankruptcy court regarding dischargeability.

Discussing both the same transaction and occurrence test, and the logical relationship test of Federal Rule of Civil Procedure 13, the Court cautiously held that where the State had asserted a claim for unpaid Underground Storage Tank fees, the chapter 7 trustee was at least entitled to offset the cost of environmental clean-up that would have ordinarily been paid from the Underground Storage Tank fund but which had been paid by the debtor. Holding that the request arose out of the same transaction, even though not part of the same transaction, the Court held there was a waiver of the Eleventh Amendment. The Court specifically declined however to determine if only offsets against filed claims were permitted or whether affirmative recoveries from a State were possible.

Finally, in Arecibo Community Health Care, Inc. v. Commonwealth of Puerto Rico, 270 F.3d 17 (1st Cir. 2001) it was held that the while the proper scope of the rule of waiver when a proof of claim was filed was in doubt, Puerto Rico[7] had not waived the protection of the Eleventh Amendment sufficiently to be sued for damages for breach of contract where it had previously filed a proof of claim for damages under the contract. This Court seemed to favor the "arising out of" standard.

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7 The Eleventh Amendment has been held applicable to Puerto Rico by the United States Court of Appeals for the First Circuit. That conclusion has not been considered by this Court. See Puerto Rico Aqueduct and Sewer Authority v. Metcalf and Eddy, 506 U.S. 139, 142 n.1 (1993).

In the instant case, the Court of Appeals for the Fourth Circuit appears to have held that unless a mandatory counter-claim is asserted there can be no litigation conduct waiver of the Eleventh Amendment in the bankruptcy context. This is inconsistent with the views of at least the United States Court of Appeals for the Ninth Circuit. In In re: Bliemeister, 296 F.3d 858 (9th Cir. 2002) the Court of Appeals found waiver had occurred when a State appeared for a hearing on the merits without raising the Eleventh Amendment objection to jurisdiction until after a sense that prevailing on the merits appeared unlikely This sneak-a-peek approach to litigation was seen as a calculated effort to attempt to escape the consequences of a voluntary appearance.

It is also inconsistent with the views of the United States Court of Appeals for the Eighth Circuit. In State of Iowa v. Union Asphalt and Roadoils, Inc., 409 F.2d 1239 (8th Cir. 1969) the Court held that when Iowa instituted an antitrust action in federal court, it consented to entry of all valid judicial orders in that case. Such orders could include the resolution of requests for payment of quantum meruit attorney's fees sought by its own counsel. The request for fees was found to have been incident to the main case, and within the ancillary jurisdiction of the federal court.[8]

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[8] Costs and attorneys fees have been considered incident to cases involving States and have long been assessed against States in the face of Eleventh Amendment claims that such awards cannot be made. See, Hutto v. Finney, 437 U.S. 678, 697 (1978)["A] federal court may treat a State like any other litigant when it assesses costs...."") and Fairmont Creamery Co. v. Minnesota, 275 U.S. 70 (1927).

The trustee in the instant case asserted that when the State filed a proof of claim , it clearly asserted a claim to property of the estate, and required the trustee to exercise his fiduciary duties on behalf of the State. Further the proof of claim required the trustee's attorneys to exercise their fiduciary responsibilities so as to benefit all creditors, including the State. These acts resulted in acquiescence in the efforts expended by the trustee sufficiently similar to that for which parties have been held responsible for the expense of counsel in litigation under the common benefit doctrine. See, Hutto v. Finney, 437 U.S. 678, 698 (1978) ("In England, costs 'as between solicitor and client,' are routinely taxed today and have been since 1278.") (citations omitted) Accepting a benefit, requires payment of the associated fees under the "common benefit" doctrine. See, Trustees of the Improvement Fund of the State of Florida v. Greenough, 105 U.S. 527 (1882)(trust, and therefore all beneficiaries, liable for fees of attorneys whose litigation efforts, improved position of all beneficiaries); Central Railroad & Banking Co. v. Pettus, 113 U.S. 116 (1885) (lack of contractual relationship with attorneys did not obviate need to contribute to payment of fees that benefited group); Hobbs v. McLean, 117 U.S. 567 (1886)(proportional contribution from all who accept benefits of attorney work product required); Harrison v. Perea, 168 U.S. 311 (1897) (defendant who was outed of independent claim to fund, but entitled to retain part of fund as a beneficiary, similar to plaintiffs, liable for pro rata share of attorney's fees on portion retained); Sprague v. Ticonic National Bank, 307 U.S. 161 (1939) (attorney's fees awarded by Court from fund secured to benefit group, including non-parties, even though no class

action formally alleged); Mills v. Electric Auto Lite Co., 396 U.S. 375 (1970) (corporation, as holder of shareholder equity, required to pay plaintiff's attorneys where one plaintiff vindicated rights of all shareholders); and Hall v. Cole, 412 U.S. 1 (1973) (union required to pay plaintiff's attorneys where one plaintiff vindicated rights of all union members).

In Confederated Tribes of the Colville Reservation Tribal Credit v. White (In re: White), 139 F.3d 1268 (1998) (Involvement of Indian Tribe in Chapter 11 proceedings sufficient to constitute a waiver of sovereign immunity of tribe in converted Chapter 7 proceedings.) Acquiescence[9] signaled the intention to accept the benefits of the efforts expended by counsel, and carried with it the burden of paying for those efforts. After accepting benefits resulting from litigation in a particular forum, there is a consequential submission to the jurisdiction of that forum for a determination of what should be paid. Accepting the benefits is litigation conduct sufficient to constitute a waiver of the Eleventh Amendment.

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[9] In Gaskill v. Gordon, 27 F.3d 248 (7th Cir. 1994) the Court of Appeals held that a creditor had acquiesced in a receivership and was liable to payment of fees of the receiver and his counsel, even where the creditor had objected to the receivership and ultimately prevailed in ousting the receiver. Acquiescence in this case existed because the creditor took no immediate effort to oust the receiver, and the creditor insisted upon holding the receiver to his fiduciary duty to protect assets that ultimately benefited the objecting creditor. The similarity between receivership and bankruptcy law warrants borrowing concepts from one of these areas to another. Scholes v. Lehman, 56 F.3d 750 (7th Cir.) (Posner, J.) cert. denied sub. nom African Enterprise, Inc. v. Scholes, 516 U.S. 1028 (1995).

WHEREFORE petitioner suggests that the petition for a writ of certiorari should be granted because there is now an important issue concerning the evaluation of litigation conduct waivers of the Eleventh Amendment in bankruptcy proceedings, and because the decision of the United States Court of Appeals for the Fourth Circuit is inconsistent with prior rulings of this Court and decisions of other Courts of Appeal.

RESPECTFULLY SUBMITTED,

Martin P. Sheehan, Esq.
WV Bar #4812

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UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Entered: January 9, 2003

In re: T&T FUELS, INCORPORATED,
Debtor.

MARTIN P. SHEEHAN, Trustee for the Bankruptcy Estate of T&T Fuels, Inc. and/or Counsel for the Trustee for the Bankruptcy Estate of T&T Fuels, Inc.,
Plaintiff-Appellant,

v.

WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION, No. 02-1026
Defendant-Appellee,

and

WEST VIRGINIA STATE TAX DEPARTMENT; PAUL THOMAS; LOWELL THOMAS; BASS ENERGY, INCORPORATED, T&T COALS, INCORPORATED, T&T MANAGEMENT COMPANY, INCORPORATED; UNITED STATES BANKRUPTCY COURT
Parties in Interest.

Appeal from the United States District Court for the Northern District of West Virginia, at Elkins.
Frederick P. Stamp, Jr., District Judge.
(CA-00-83-2, BK-95-21264)

Argued: December 3, 2002

Entered: January 9, 2003

Before WILLIAMS and TRAXLER, Circuit Judges, and HAMILTON, Senior Circuit Judge.

Affirmed by unpublished per curiam opinion.

COUNSEL

ARGUED: Martin Patrick Sheehan, SHEEHAN & NUGENT, P.L.L.C., Wheeling, West Virginia; William Anthony Kolibash, PHILLIPS, GARDILL, KAISER & ALTMEYER, Wheeling, West Virginia, for Appellant, Mark J. Rudolph, Office of Legal Services, DEPARTMENT OF ENVIRONMENTAL PROTECTION, Charleston, West Virginia, for Appellee. **ON BRIEF:** Denise Knouse-Snyder, PHILLIPS, GARDILL, KAISER & ALTMEYER, Wheeling, West Virginia, for Appellant, Christopher d. Negley, Office of Legal Services, DEPARTMENT OF ENVIRONMENTAL PROTECTION, Charleston, West Virginia, for Appellee.

Unpublished opinions are not binding precedent in this circuit. See Local Rule 36(c).

OPINION

PER CURIAM:

Martin P. Sheehan, a trustee in bankruptcy for T&T Fuels, Inc., filed a motion in bankruptcy court for imposition of a constructive trust and for a direct payment of quantum meruit fees by the West Virginia Department of Environ-mental Protection (DEP). Sheehan's claim was based on work performed by counsel that he, as trustee, retained to pursue causes of action against the two directors of T&T Fuels, Paul and Lowell Thomas. The bankruptcy court concluded that Sheehan's claim against the DEP was barred by the Eleventh Amendment and thus denied the motion. The district court affirmed. Sheehan now appeals the district court's decision. Because we agree with the district court's analysis and conclusion, we affirm.

I.

T&T Fuels mined coal in Preston County, West Virginia from 1971 to 1993. These mining activities produced large quantities of acid mine drainage, and in 194, acid-laden water began to discharge directly into waters of West Virginia. The DEP issued several violation notices and cessation orders requiring T&T Fuels to treat the discharge from its mines and assessed mandatory civil penalties.

On October 27, 1995, T&T fuels filed a Chapter 7 bankruptcy petition, and Sheehan was appointed as trustee. The DEP began treatment of the site and immunized Sheehan from any personal liability. The

DEP filed a multimillion dollar proof of claim against the bankruptcy estate, to which Sheehan objected. In September 1996, a trial was held in bankruptcy court on the DEP's claim, and on February 20, 1997, the bankruptcy court determined the amount of the DEP's claim at $6.7 million and changed its status from administrative priority to general unsecured. The DEP's claim was intended to fund twenty years of treatment of the damage caused by the acid mine drainage. Although there were several claims filed against the debtor, the DEP's claim exceed the total of all other claims filed.

Sheehan employed counsel on a contingent fee basis to pursue claims against the two directors of T&T Fuels, Paul Thomas, and his brother, Lowell Thomas, and several entities owned by them for breach of fiduciary duty and a disguised fraudulent transfer. The United States charged Paul Thomas with criminal violations of the Clean Water Act. In the criminal case, which was not covered by the automatic stay in the bankruptcy action, the United States and Paul Thomas entered into a plea agreement whereby Thomas received five years probation. Paul Thomas also entered into an agreement with the United States in which he agreed to pay restitution to the DEP in the amount of $443,400 for land reclamation costs and penalties, as well as $33,000 per month to treat the water flowing from T&T Fuels as long as acid drainage persisted. As a result of these agreements, the DEP withdrew its proof of claim against the bankruptcy estate. Sheehan did not object to the DEP's withdrawal.

Sheehan settled the claims that he brought against the Thomas brothers and the various entities owned by them for a little over $100,000 . With the sums received from the settlement, and the funds previously generated from the sale of T&T Fuel's assets, Sheehan prepared a report seeking authority to distribute the funds. Although the attorneys Sheehan hired were entitled to fees on a contingent fee basis measured by the benefit to the estate, they reduced their fees so that unsecured creditors creditors could receive at least 50% of the amount for which the unsecured creditors had filed proofs of claim.

On November 2, 1999, Sheehan filed a motion in the bankruptcy court, requesting that a constructive trust be imposed on the DEP and that the court require the DEP to make a direct payment of a quantum meruit fee for the benefit the DEP received as a result of the efforts of Sheehan's attorneys in the bankruptcy proceedings. The bankruptcy court held that although the attorneys per-formed valuable services for the DEP and should, as a matter of moral principle, be compensated by the DEP, the Eleventh Amendment barred Sheehan's claim for attorneys' fees against the DEP. Sheehan appealed the bankruptcy court's decision to the district court, and on December 12, 2001, the district court affirmed the decision of the bank-ruptcy court. This appeal followed. This court has juris-diction pursuant to 28 U.S.C.A. § 1589d) (West 1993).

On appeal, Sheehan contends that by filing a proof of claim, the DEP waived its Eleventh Amendment immunity to his claim for attorneys' fees.

Because Sheehan's appeal raises an issue of law, our review is de novo. *Accord Cypher Chiropractic Ctr. v. Runski (In re Runski)*, 102 F.3d 744, 745 (45h Cir. 1996).

II.

The Eleventh Amendment, in conjunction with related principles of state sovereign immunity, bars federal courts from hearing any suit "commenced or prosecuted against one of the United States by Citizens of another State," U.S. Const. amend. XI, or by its own citizens, *Hans v. Louisiana*, 134 U.S. 1, 10, 20 (1890). A state, of course, remains free to waive its immunity from suit in a federal court. *See, e.g., Lapides v. Bd. of Regents of the Univ. Sys. of Ga.*, _ U.S. _, 122 S.Ct. 1640, 1646 (2002) (holding that a state waives Eleventh Amendment immunity when it removes a case from state court to federal court). The only issue presented in this appeal is whether the DEP waived its Eleventh Amendment immunity.*********

While the Court in *Lapides* did not address the scope of such a waiver, the Court previously has held that when a state "files a claim against the fund [in a bankruptcy action] it waives any immunity which it otherwise might have had respecting the adjudication

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*********We do not address Sheehan's argument that our previous decision holding that "Congress has no authority under the Bankruptcy Clause, U.S. Const. art. I, § 8, cl. 4, to abrogate state sovereign immunity in federal courts, "*Schlossberg v. Maryland (In re Creative Goldsmith of Washington, D.C., Inc.)*, 199 F.3d 1140, 1145 (4th Cir. 1997), should be reconsidered and overruled. *See Laughlin v. Metro. Wash. Airports Auth.*, 149 F.3d 253, 260 (4th Cir. 1998) (stating that a panel cannot overrule a decision of a prior panel).

of the claim." *See Gardner v. New Jersey*, 329 U.S. 565, 574 (1947). The Court in *Gardner* reasoned that if a state invokes the aid of the bankruptcy court in collecting a debt, it must submit to the bankruptcy court's process of adjudicating the competing interests in the bankruptcy estate. *Id.* We have held "that to the extent a defendant's assertions in a state-instituted federal action, including those made with regard to a state-filed proof of claim in a bankruptcy action, amount to a *compulsory* counterclaim, a state has waived any Eleventh Amendment immunity against that counterclaim in order to avail itself of the federal forum." *Schlossberg v. Maryland (In re Creative Goldsmith of Washington, D.C., Inc.)*, 119 F.3d 1140, 1148 (4th Cir. 1997).

A counterclaim is compulsory "if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim." Fed. R. Civ. P. 13(a). Sheehan's action in this case, for attorney's fees incurred pursuing causes of action for the bankruptcy estate, does not arise out of the same transaction or occurrence supporting the DEP's proof of claim for pollution clean-up. Rather, Sheehan's claim arises from the DEP's decision to enter into a plea agreement with Paul Thomas and withdraw its proof of claim. Adjudicating Sheehan's claim, therefore, would require more than a determination of DEP's interest in a bankruptcy estate. Specifically, it would require the bankruptcy court to exercise jurisdiction over the DEP, as opposed to a bankruptcy estate, *see Virginia v. Collins (In re Collins)*, 173 F.3d 924, 928 (4th Cir. 1999) ("[T]he power of the bankruptcy court to enter an order confirming a plan . . . derives not from

jurisdiction over the state or other creditors, but rather from jurisdiction over the state or other creditors, but rather from jurisdiction over debtors and their estates" (internal citation omitted)), and to determine whether Sheehan's attorneys should receive payment from the West Virginia Treasury for the benefit of their services to the state, thus possibly entering a judgment against the DEP, *see Gardner*, 329 U.S. at 574 (explaining that while a state's proof of claim may be "rejected in toto, reduced in part, given a priority inferior to that claimed, or satisfied in some way other than payment in case," no judgment is entered against the state). Because Sheehan's claim for attorneys' fees does not amount to a compulsory counterclaim against DEP's proof of claim, the DEP has not waived its Eleventh Amendment immunity with respect to the adjudication of Sheehan's claim.

III.

Having reviewed the record, briefs, and applicable law and having considered the oral arguments of the parties, we conclude that the district court was correct. Accordingly, we affirm on the basis of the district court's well-reasoned opinion. *See Sheehan v. W. Va. Dep't of Envtl. Prot. (In re T&T Fuels, Inc.)*, 2:00CV83 (N.D. W. Va. Dec 12, 2001).

AFFIRMED

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF WEST VIRGINIA

IN RE:

Civil Action No. 2:00CV83
Bankruptcy No. 95-21264
(STAMP)

T&T FUELS, INC.,

Debtor.

MARTIN P. SHEEHAN, Trustee for the Bankruptcy Estate of T&T Fuels, Inc. and/or Counsel for the Trustee for the Bankruptcy Estate of T&T Fuels, Inc.,

Appellant,

v.

WEST VIRGINIA DIVISION OF ENVIRONMENTAL PROTECTION,

Appellee.

Entered December 12, 2001

MEMORANDUM OPINION AND ORDER AFFIRMING THE BANKRUPTCY COURT'S ORDER

I. Procedural History

On August 21, 2000, the Bankruptcy Court entered an order denying the motion of appellant, Martin P. Sheehan, Trustee in Bankruptcy for T&T Fuels, Inc., for imposition of a constructive trust and for a direct payment of quantum meruit fees by the West Virginia Department of Environmental Protection. On August 30, 2000, the appellant filed a notice of appeal. After receiving the bankruptcy records, the Honorable Robert E. Maxwell transferred this action to the undersigned judge on October 20, 2000.

This Court has reviewed the applicable law, the Bankruptcy Court record, and the briefs in support of and in opposition to this appeal. For the reasons stated below, this Court finds that the Bankruptcy Court's order should be affirmed.

II. Jurisdiction and Standard of Review

This Court has jurisdiction over this bankruptcy appeal pursuant to 28 U.S.C. § 158(a) and Bankruptcy Rule 8001. This Court has reviewed the factual findings of the Bankruptcy Judge under a clearly erroneous standard of review, Bankruptcy Rule 8013, and has reviewed the conclusions of law under a de novo standard of review. See In re NVR, 189 F.3d 442, 448 (4th Cir. 1999).

III. Facts

T&T Fuels, Inc. ("T&T") mined coal owned by Kingwood Coal Company in Preston County, West Virginia from 1971 to 1993. These mining activities produced large quantities of acid mine drainage and in 1994, a large breakout of acid-laden water began to discharge directly into the waters of West Virginia. The West Virginia Department of Environmental Protection ("DEP") issued several notices of violations and cessation orders requiring T&T to treat the discharge from its mines and assessing mandatory civil penalties. On October 27, 1995, T&T filed a Chapter 7 bankruptcy petition and Martin Sheehan was appointed as trustee. The DEP filed a multimillion dollar proof of claim against the bankruptcy estate, to which the trustee objected. In September 1996, a trial was held on the DEP's claim and on February 20, 1997, the Bankruptcy Court issued its memorandum opinion and order settling the DEP's claim at $6.7 million and changing the status from administrative priority to general unsecured. This money was to fund 20 years of treatment of the damage done by the acid mine drainage. Although there were several claims filed against the debtor, the claim of the DEP exceeded the total of all other claims filed.

The trustee employed counsel on a contingent fee basis to pursue claims against the directors of T&T for breach of fiduciary duty and a disguised fraudulent transfer. Various suits were pursed against Paul Thomas, his brother, Lowell Thomas, and several entities owned by them. In addition to the litigation brought by the trustee, Paul Thomas was eventually

prosecuted by the United States for violations of the Clean Water Act. Thomas entered into a plea agreement with the United States and received five years probation. In addition, the United States and Thomas entered into an agreement whereby Thomas agreed to pay restitution to the DEP. The order of restitution directed Thomas to pay the State of West Virginia $443,400.00 for penalties and land reclamation costs and $33,000.00 per month to treat the water flowing from the T&T mines as long as acid mine drainage exists. As a result of this compromise, the DEP withdrew its proof of claim against the bankruptcy estate. The trustee did not object to the DEP's withdrawal.

The trustee settled the claims that he brought against the Thomas brothers and the various entities owned by them for a little over $100,000.00. With the sums received from the settlement, and the funds previously generated by the trustee from the sale of T&T assets, a report seeking authority to distribute funds was prepared. Although the attorneys hired by the trustee were entitled to fees on a contingent fee basis measured by the benefit to the estate, they reduced their fees so that unsecured creditors could receive at least fifty percent of the amount for which they had filed proofs of claim.

On November 2, 1999, the trustee filed a motion in the Bankruptcy Court, moving the court to order that a constructive trust be imposed on the DEP and that the DEP be required to make a direct payment of a quantum meruit fee to the trustee and his attorneys for the benefits enjoyed by the DEP as a result of the

trustee and his attorneys' efforts in the bankruptcy proceedings. The Bankruptcy Court made no finding as to the trustee's rights under quantum meruit. It held, instead, that although the attorneys for the trustee performed valuable services for the DEP and the court believed that the State of West Virginia, should, at a minimum as a matter of moral principle, reimburse the estate attorneys for the amount of money they reduced their hourly fee, the Eleventh Amendment barred the trustee's claim for attorney's fees against the DEP.

The appellant has presented two issues on appeal. The first issue is whether the Eleventh Amendment is available as a jurisdictional defense to a state agency that has filed a claim in Bankruptcy Court. The appellant states that he recognizes that at this level of appeal, this issue must be determined adversely to him because the Fourth Circuit has held that the Eleventh Amendment is available as a jurisdictional defense, at least in some circumstances, to a state agency that has filed a claim in Bankruptcy Court. The appellant asserts that this issue is included, in good faith, solely to preserve the issue, should it be necessary for review by the Fourth Circuit or the United States Supreme Court. Therefore, the second and only issue presented to this Court is whether the DEP waived the protection of the Eleventh Amendment and consented to jurisdiction in Bankruptcy Court as a result of filing a proof of claim in the Bankruptcy Court, participating in the bankruptcy proceedings, acquiescing in and supporting the bankruptcy trustee's actions in carrying out his fiduciary duty to the bankruptcy estate, and

benefiting from the efforts of the trustee's counsel which may have helped the DEP to reach a restitution agreement in a separate criminal action. The appellant asks this Court to declare that the Eleventh Amendment is unavailable as a defense and to remand this matter for further proceedings to determine the appropriate fee.

The appellee argues in response that it did not waive its Eleventh Amendment immunity nor give actual consent to federal jurisdiction. The appellee further argues that the appellant is limited in federal court to those strict fee application standards set forth in the Bankruptcy Code or he must pursue common law equity claims in the state court of claims.

IV. Discussion

The Eleventh Amendment to the United States Constitution provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." U.S. Const. Amend. XI. Thus, under the Eleventh Amendment, federal courts are denied the authority to entertain a suit brought by a private party against a state without that state's consent. See Ford Motor Co. v. Dep't of Treasury of Indiana, 323 U.S. 459 (1945). It is well established, though not expressly stated in the Constitution, that the Eleventh Amendment also prohibits a state from being sued by its own citizens. See Hans v. Louisiana, 134 U.S. 1, 20-21 (1890). It is also well established that Eleventh Amendment

immunity extends to "arms of the state" such as state agents, officials, and instrumentalities. See Regents of the Univ. of California v. Doe, 519 U.S. 425, 429 (1997). In the present case, the parties do not dispute that DEP is an arm of the state for Eleventh Amendment purposes.

In Schlossberg v. State of Maryland, 119 F.3d 1140, 1147 (4th Cir. 1997), the Fourth Circuit held that the Bankruptcy Improvement Act of 1994, 11 U.S.C. § 106, which expressly abrogates sovereign immunity as to a governmental unit including a state, is unconstitutional and ineffective. The court held that "in the absence of a constitutional authorization, it lies solely within a state's sovereign power to waive its immunity voluntarily and to consent to federal jurisdiction. Only if it waives such immunity may a private citizen sue the state in federal court." Id.

Generally, a state will be deemed to have waived its immunity from federal-court jurisdiction if it voluntarily invokes the court's jurisdiction or makes a clear declaration that it intends to submit to federal jurisdiction. See College Savings Bank v. Florida Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 676 (1999). In order to determine whether a state has waived its Eleventh Amendment immunity and has consented to jurisdiction, a court must examine whether a state's consent to be sued in federal court is "clearly intended by its state law and implemented by an officer acting properly under that law." Schlossberg, 119 F.3d 1148. The court also must "look to state law when a state has voluntarily initiated an action in federal court to determine whether the state

officer is authorized to proceed in federal court." Id. "When a state authorizes its officials voluntarily to invoke federal process in a federal forum, the state thereby consents to the federal forum's rules of procedure and may not invoke sovereign immunity to protect itself against the interposition of defenses to its action." Id. However, a state's waiver of immunity must be "narrowly construed." Id.

The appellant does not contend that the law of West Virginia expressly waives the state's Eleventh Amendment immunity in the context of bankruptcy proceedings. Rather, the appellant essentially argues that the DEP impliedly or constructively waived its immunity by filing a proof of claim in the Bankruptcy Court.

"It has long been held that when a state is a creditor, bankruptcy procedure for proof and allowance of claims does not operate as a suit against a state in violation of the Eleventh Amendment." In re Collins, 173 F.3d 924, 930 (4th Cir. 1999); see also Gardner v. New Jersey, 329 U.S. 565, 574-75 (1947). This is because the filing of a bankruptcy petition is not considered a suit against the state, but rather the state may voluntarily submit to federal jurisdiction as a creditor so that it has the opportunity to share in the estate. See id. The Bankruptcy Court does not have jurisdiction over the state, but has jurisdiction over the debtor and his estate. See id. Thus, by filing a proof of claim, the state essentially waives its Eleventh Amendment immunity, at least by some degree.

The Fourth Circuit has held that "to the extent that a defendant's assertions in a state-instituted federal action, including those made with regard to a state-filed proof of claim in a bankruptcy action, amount to a compulsory counterclaim, a state has waived any Eleventh Amendment immunity against that counterclaim in order to avail itself of the federal forum." Schlossberg, 119 F.3d at 1148. However, in order for a claim against the state to be construed as a compulsory counterclaim to the state's proof of claim, the claim must arise out of the same transaction or occurrence affording the state's proof of claim. See id. at 1149.

The appellant sets forth that the dispute in this appeal is whether Schlossberg holds that consent to jurisdiction from voluntary participation in federal litigation can be inferred whenever there has been voluntary participation or whether consent may be inferred only where a mandatory counterclaim exists. The appellant argues that the voluntariness of state participation in litigation and the necessary scope of the litigation are the relevant criteria for determining if there has been a voluntary waiver of the Eleventh Amendment. The appellee argues in response that its proof of claim does not arise out of the same transaction or occurrence as the trustee's claim and therefore, according to Schlossberg, the DEP has not waived its sovereign immunity by filing its proof of claim.

This Court has not found case law in the Fourth Circuit or anywhere else that has similar facts or answers this question. However, the principles set

forth by several Fourth Circuit cases lead this Court to find that the Bankruptcy Court decision should be affirmed.

There is no doubt that the ultimate resolution of the dispute between the trustee and the DEP requires that this Court exercise jurisdiction over the State of West Virginia. Further, the appellant is demanding payment from the West Virginia Treasury. The criminal restitution money that is being paid by Paul Thomas is deposited in West Virginia's Special Reclamation Fund, which is held in the State Treasury. This money is designated to go directly to the costs associated with the treatment of the acid mine drainage at the former T&T site. "The demand for money from the state is a strong indication that a federal judicial proceeding is indeed a suit against the state under the Eleventh Amendment." In re NVR, 189 F.3d at 454. The Bankruptcy Court's decision was based on the compelling fact that the only fund available to pay the trustee and his attorneys is the money in the state treasury, which is protected by the Eleventh Amendment. This Court agrees with that assertion as well as the Bankruptcy Court's finding that the DEP did not waive its Eleventh Amendment immunity.

Although, as the appellant contends, the Schlossberg opinion may not have considered the impact of the Eleventh Amendment on every possible type of suit that may arise when a state files a proof of claim in the Bankruptcy Court, the case law presented by the appellant does not convince this Court that the state has waived its Eleventh Amendment immunity in this particular factual situation. In the case at hand, the

debtor corporation, T&T Fuels, filed a voluntary petition for bankruptcy. A creditor, which happened to be the State of West Virginia, filed a proof of claim in that bankruptcy proceeding. This creditor also happened to be a victim of a crime. The owner of the debtor corporation was prosecuted, and the victim of the crime agreed to withdraw its claim in bankruptcy and accept restitution instead. It is quite evident from the transcript of a status conference held on November 21, 1997 in the criminal action against Paul Thomas that the DEP was motivated to accept restitution and withdraw its proof of claim from the bankruptcy proceeding by the fact that any award from the bankruptcy court would be reduced by trustee and attorneys' fees. By accepting restitution, all of the money would go directly to the state to treat the acid mine drainage. This Court agrees with the Bankruptcy Court's finding that the trustee and his attorneys performed valuable services for the State of West Virginia during the time that the state had a proof of claim in the bankruptcy proceeding and that the effort by the trustee and these attorneys benefited the state in its ultimate restitution agreement. This Court also agrees with the Bankruptcy Court's further finding that the State of West Virginia should, at a minimum, as a matter of moral principle reimburse the trustee and his attorneys for the amount of money they reduced their hourly fees. Nevertheless, the Bankruptcy Court correctly concluded that it did not have jurisdiction to order the DEP to pay the attorneys' fees claimed by the trustee because the state is protected from such a suit by the Eleventh Amendment.

This Court does not find that the DEP waived the protection of the Eleventh Amendment and consented to the jurisdiction of the Bankruptcy Court over the trustee's quantum meruit claim as a result of filing a proof of claim. It is well established that a state may not constructively or impliedly waive its sovereign or Eleventh Amendment immunity, but must "unequivocally express [ ]" its waiver of immunity. College Savings Bank, 527 U.S. at 682. Fourth Circuit case law makes it clear that the filing of a proof of claim in a bankruptcy proceeding by a state does not implicate the Eleventh Amendment because the state is not being compelled to come into court. Further, the Fourth Circuit has carved out a very narrow exception of when a state that files a proof of claim in a bankruptcy action can have a claim asserted against it. As stated above, the Schlossberg court held that if a claim asserted against a state amounts to a compulsory counterclaim, then the state has waived its Eleventh Amendment immunity against that counterclaim. Schlossberg, 119 F.3d at 1148.

In Schlossberg, the State of Maryland filed a proof of claim in the debtor's bankruptcy to recover one type of tax, and the trustee filed an adversary proceeding in the bankruptcy court against the state to avoid as a preference the payment of another type of tax made by the debtor. The court held that the trustee's action "cannot be construed under federal law as a claim in the nature of a compulsory counterclaim to the state's proof of claim." Id. at 1149. The court accordingly found that it had "no authority to entertain this action absent Maryland's consent." Id. at 1150 (citation omitted). It is possible, as the appellant

argues, that the Schlossberg court may not have meant that this is the only time that a state that files a proof of claim waives its Eleventh Amendment immunity. However, in light of the principles discussed above, most importantly the principle that any waiver of immunity must be narrowly construed, this Court refuses to expand the situations when a state waives its immunity any further.

The appellant attempts to borrow from the law of receivership in order to further boost his argument that the DEP has waived its immunity and should be required to pay under these circumstances. The appellant sites Scholes v. Lehmann, 56 F.3d 750 (7th Cir. 1995), to stand for the proposition that receivers and trustees are similar and therefore it is appropriate to borrow law from one area to the other. A receiver is akin to a trustee and is traditionally defined as:

> A person appointed by a court for the purpose of preserving property of a debtor pending an action against him, or applying the property in satisfaction of a creditor's claim, whenever there is danger that, in the absence of such an appointment, the property will be lost, removed, or injured.

Black's Law Dictionary 1268 (1990). A receiver generally looks to the property that he has managed for payment. However, even in the event that the property is unavailable or the receiver was improperly appointed, the receiver most often gets paid. The appellant also cites cases that stand for the proposition

that if the receivership is wrongfully invoked, the party initiating the receivership must pay. The few cases cited by the appellant that have required government entities to pay for the receivership are easily distinguishable and do not persuade this Court.

In Theaters of America, Inc. v. Texas, 577 S.W.2d 542 (Tex. Civ. App. 1979), the state of Texas filed a petition for a temporary restraining order and ultimately a permanent injunction in state court against a corporation to prevent that corporation from conducting any business in the state without a proper certificate of authority. The state requested that the court appoint a receiver to take charge of the affairs and the property of the corporation in order to preserve the property and recover certain funds due to the state. See id. at 543. The defendants then filed suit in United States District Court against the Texas Attorney General, the receiver, and others, claiming that at least one of the motives of the state in filing for a temporary restraining order and permanent injunction was to shut down the theater due to the content of the films which the state officials believed to be pornographic, thereby violating the First Amendment rights of the defendants. See id. at 544. The district court found that the state's actions were done in bad faith and for the purpose of harassing the plaintiffs and suppressing their Constitutionally protected conduct. See id. The receiver was enjoined from acting as a receiver in the state court case. See id. The state court then ordered that certain fees of the receivership be taxed against the state and that the rest of the fees be taxed against the defendant corporation. See id. at 546. The corporation appealed and the Court of Civil

Appeals found that the state must pay the entire cost of the receivership because '[t]he expenses of the receivership must come from the party whose wrongful act brought about the appointment of the receiver." Id. at 548. Theaters of America can be distinguished from the case at hand because the DEP did not cause the bankruptcy petition to be filed, and did not engage in any wrongful conduct in order to bring about the petition for bankruptcy or the appointment of the trustee. Further, sovereign immunity was not an issue that was raised in Theaters of America.

Another case cited by the appellant is United States v. Paccione, 730 F.Supp. 1237 (S.D. N.Y. 1990). In Paccione, during a criminal RICO prosecution, the government asked the court to appoint a receiver to oversee the defendant's assets and business interests pending trial. See id. at 1237. The court concluded that the government should initially pay for the cost of the receivership because a provision of the RICO statute, 18 U.S.C. § 1963(f), provides the government with the ability to recover any expenditures in the event that it obtains a RICO conviction and forfeiture. See id. at 1239. The court found that "[t]he only time the Government is at risk for the costs of the [receiver] is the period in which the presumption of innocence continues to provide defendants protection and then, ultimately, only if defendants are acquitted or the property deemed not forfeitable." Id. The Eleventh Amendment was not raised as a defense in this case and the court only required the government to pay for the receivership because the RICO statute allows the government to be reimbursed for its expenditures.

In United States v. Ianniello, 824 F.2d 203 (2d Cir. 1987), after prosecuting a criminal RICO case against defendants who were ultimately convicted for skimming the receipts of several restaurants, the government commenced a civil RICO suit. See id. at 203. The civil complaint sought injunctive relief against the participation by several of the defendants in the restaurant business, and an order compelling divestiture of their holdings in any bars or restaurants, including a restaurant called Umberto's. See id. The government moved for the appointment of receiver for Umberto's, which was granted. On appeal, the Second Circuit held:

> Since the benefit of the receivership is . . . enjoyed by the public, it seems appropriate at this stage to impose the costs of the receivership on the government, at least pending a resolution of the charges against the defendants. If it is established that Umberto's as a corporate entity has benefitted from the receivership, it might then be appropriate to reimburse the government for some, or perhaps all, of the expenses of the receiver.

Id. at 209. There is no indication that the government asserted the Eleventh Amendment as a defense in this action. Further, the receivership in Ianniello was initiated by the government whereas the bankruptcy petition in the case at hand was not. The DEP had the

option of filing a proof of claim, which was ultimately withdrawn without objection from the trustee.

Based on the foregoing, this Court finds that even if it were to apply the law of receivership to the case at hand, the appellant has not demonstrated that the DEP has waived its Eleventh Amendment immunity and should be required to pay the attorneys' fees. The receivership cases cited by the appellant that required the state to pay for the receivership, contain very particular factual situations that cannot be applied to the case at hand.

Although this Court finds that the DEP is immune from the trustee's quantum meruit suit in this Court, the appellants are not without a remedy. The appellee does not seem to deny that it may have a moral obligation to reimburse the trustee and his attorneys for the amount that they reduced their hourly fees, as suggested by the Bankruptcy Judge. As the appellee notes, the appellants could bring their claim for attorneys' fees in the West Virginia Court of Claims pursuant to West Virginia Code § 14-2-13(1). The Supreme Court of Appeals of West Virginia described the Court of Claims in the following way:

> The Court of Claims is an administrative arm of the West Virginia Legislature, not a court created within the judicial branch of the government. The Legislature has established the Court of Claims by law and delegated to it the Legislature's power to investigate certain claims against the State that may not be

> prosecuted in the courts because of the State's sovereign immunity. The Court of Claims is also charged by law with the duty of recommending payment of such of those claims as it finds worthy, in specified amounts, to be paid by specific appropriations designated by the Legislature for payment of claims against the State, which it recognizes as a moral obligation of the State notwithstanding the immunity of the State from suit in its various courts.

West Virginia ex rel McLaughlin v. West Virginia Court of Claims, 549 S.E.2d 286, 289 (W. Va. 2001) (citations omitted). The appellant has not refuted the DEP's contention that appellant's quantum meruit action could be brought in the Court of Claims.

V. Conclusion

For the reasons stated above, this Court finds that the August 21, 2000 order of the Bankruptcy Court denying the appellant's motion for the imposition of a constructive trust and for a direct payment of a quantum meruit fee by the DEP should be and hereby is AFFIRMED. It is further ORDERED that this appeal should be and hereby is DISMISSED and STRICKEN from the active docket of this Court.

IT IS SO ORDERED.

The Clerk is DIRECTED to transmit copies of this order to counsel of record herein. Pursuant to Federal Rule of Civil Procedure 58, the Clerk is DIRECTED to enter judgment on this matter.

DATED: December 12, 2001

s/Frederick P. Stamp, Jr.
FREDERICK P. STAMP, JR.
UNITED STATES DISTRICT JUDGE

UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF WEST VIRGINIA

IN RE	§	
	§	
T & T FUELS, INC.,	§	BK NO. 95-21264
	§	
Debtor(s).	§	

Entered August 21, 2000

ORDER

The Trustee has filed a "Motion by Counsel for the Trustee for Imposition of a Constructive Trust and for a Direct Payment of Quantum Meruit Fee by the West Virginia Department of Environmental Protection with Supporting Authorities." By this motion, the attorneys for the trustee seek to impose a constructive trust of funds of the West Virginia Department of Environmental Protection.

The first issue to address is the 11th Amendment or state sovereign immunity. Both parties have submitted briefs in this regard.

FACTS

T & T Fuels, Inc. ("T&T") is a corporation organized to do business in the State of West Virginia. Its primary business had been mining coal in Preston County from 1971 to 1993. In 1994, large breakout of water occurred on the T&T premises. T&T was unable

to treat the large quantity of water flowing from the mine. On October 27, 1995, T&T filed its Chapter 7 bankruptcy petition.

T&T leased the real property and owned some coal mining equipment. There were several claims filed against the Debtor, but the claim of the State of West Virginia for $36 million to pay for the damages caused by the acid mine drainage and for future treatment far exceeded the total of all other claims filed.

A hearing was held on the State's claim and the Court valued it at $6.7 million. The Debtor's assets were less than $200,000.

Under state law, the State had not only remedies against the Debtor, but could also pursue criminal actions against the operator of T&T, Paul Thomas ("Thomas"). As a part of the criminal proceedings, Thomas and the State of West Virginia entered into a compromise whereby Thomas had to pay the State $43,400 for penalties and land reclamation costs. In addition, Thomas agreed to pay $36,000 per month to treat the water flowing from the T&T mine as long as acid mine drainage exists. Due to the compromise, the State withdrew its claim of $36 million (Court reduced to $6.7 million) against the Debtor, T&T.

The funds generated from the sale of T&T assets have been distributed to creditors. There are no assets remaining. The trustee seeks payment from the State for payment of the quantum merit fee. The trustee asserts that his actions in instituting an adversary

proceeding and the activities pursued by him in that action brought about the criminal restitution agreement signed by Thomas.

The Court makes no finding as to the Trustee's rights under quantum merit. The sole issue addressed herein is the State's protection from this claim under the Eleventh Amendment.

The recent issue of state sovereign immunity under the 11th Amendment arose with the case of Seminole Indian Tribe of Florida v. Florida, 517 U.S. 44, 116 S.Ct. 1114 (1996). This was not a bankruptcy case, but it soon became apparent that the case had bankruptcy implications.

The Fourth Circuit soon confronted the issue in bankruptcy. In In re Schlossberg, 119 F.3d 1140 (4th Cir. 1997) the Court held that the Bankruptcy Code provision purporting to abrogate states' sovereign immunity was unconstitutional. The issue was whether or not the state had waived its defense of sovereign immunity. The court said that as to compulsory counterclaim in state instituted actions, the state had waived.

In In re Creative Goldsmith of Washington, D.C., Inc., 119 F.3d 1140 (4th Cir. 1997) the court held the state's proof of claim or other participation in a bankruptcy did not waive the state's defense of immunity in an action brought against it by the trustee.

In In re N.R.R., 189 F.3d 442 (4th Cir. 1999), a Chapter 11 debtor moved for an order requiring the

state taxing authorities to refund real estate recording taxes. This case was brought by motion and not an adversary proceeding. However, the court stressed the need to look not only at the form but the substance. The court concluded the substance of the motion was to receive the return of a payment made to the state, and the state was entitled to defend upon the basis of sovereign immunity.

In In re Collins, 173 F.3d 924 (4th Cir. 1999) the state started garnishment proceedings after the debtor had been discharged in bankruptcy. The debtor filed a motion to reopen the bankruptcy case to determine the dischargeability of the debt to the state. The Fourth Circuit found that the case was not a suit against the state and that the bankruptcy court did not deed to assert jurisdiction over the state to determine the dischargeability of the debt - - the Court had the power to determine the dischargeability issue because it had jurisdiction over the debtor and his case.

There have been numerous decisions outside the Fourth Circuit, but this Court is bound by the decisions of this Circuit. Commentators have attempted to establish guiding principles with respect to the cases involving sovereign immunity and these principles generally comport with the findings of the Fourth Circuit. A summary of these decisions follows.

First, the filing of a bankruptcy petition in itself does not constitute a suit against the state.

Second, certain orders and rulings entered by the bankruptcy court in the course of a bankruptcy case

are not issued in the context of a suit against the state and thus not prohibited by the Eleventh Amendment irrespective of the impact on a state's interest. For example, entry of a discharge order, confirmation of a plan and allowance or disallowance of a proof of claim filed by the state.

Lastly, the state may not be a defendant in a suit that requires the state to pay out money.

Of all the reasoning for the sovereign immunity defense, the inability to raid the state's treasury is the most compelling. Funds received by the state from its taxing revenue are to be spent for the general welfare of the state's citizens and not to benefit one individual plaintiff.

The State of West Virginia and the West Virginia Division of Environmental Protection have not explicitly waived their Eleventh Amendment immunity. West Virginia Constitution Article VI, Section 35 provides that "the State of West Virginia shall never be made a defendant in any court of law or equity, except the State of West Virginia, including any subdivision thereof, or any municipality therein, or any officer, agent, or employee thereof, may be a defendant in any garnishment or attachment proceeding, of garnishee or suggestee."

The Fourth Circuit, considering that West Virginia had waived some constitutional immunity in cases which the State carried applicable insurance policies, found that those waivers could at most "be

construed as waiving the State's immunity from suit in state court."

Westinghouse Elec. Corp. v. W.Va. Dept. of Highways, 845 F.2d 468, 470 (4th Cir. 1988).

Although a state can waive Eleventh Amendment immunity by initiating legal action, the state has not waived immunity from suit by filing a proof of claim in the bankruptcy court. A state can waive its sovereign immunity when it voluntarily enters a federal forum and institutes an action in its own interests. Specifically, a state cannot initiate an action and then invoke sovereign immunity to protect itself against the imposition of defense to its action. To the extent that a defendant's assertions amount to a compulsory counterclaim, a state has waived its sovereign immunity. In re Creative Goldsmith of Washington. D. D., Inc., supra.

The Court agrees that the attorneys for the Trustee performed valuable services and their time records submitted to the Court reveal a substantial amount of time expended in the adversary proceeding against the operator of the Debtor, Paul Thomas.

The firm of Phillips, Gardill, Kaiser and Altmeyer had over 400 hours accumulated and the firm of Sheehan and Nugent of 450 hours. The defense lawyers were avidly representing their client and several hearings were held by the Court and some matters appealed. The accounting records were voluminous and many hours were spent by the estate attorneys coordinating their efforts with the efforts of

the State of West Virginia and the United States. The Court is persuaded that the efforts by the attorneys for the estate benefitted the State of West Virginia in its ultimate restitution agreement.

The estate assets were not sufficient to pay all the creditors' claims and the hourly fees charged by the attorneys for the estate. In a spirit of compromise, the attorneys for the estate reduced their claims to allow the priority claimants to be paid in full and the general unsecured creditors to receive 50 percent of their claims.

It is the court's personal opinion that the State of West Virginia should at a minimum as a matter of moral principle reimburse the estate attorneys for the amount of money they reduced their hourly fees. But the Court's personal opinion is not relevant. The rulings of this Court must have a basis of law.

The Trustee's motion seeks to have the State pay him money that the State would otherwise receive from Thomas. Thomas is not a debtor and as previously stated, the Debtor has no assets. Thomas is payment $36,000 per month to the State of West Virginia. The State of West Virginia is expending $36,000 per month to prevent acid mine drainage at the T & T mine site. There is not a fund that the State is holding on behalf of the Debtor and/or Thomas. The only "fund" available to pay the money is the State Treasury. The State Treasury is protected by the Eleventh Amendment.

Accordingly, the Motion by Counsel for the Trustee for Imposition of a Constructive Trust and for a Direct Payment of Quantum Meruit Fee by the West Virginia Department of Environmental Protection is **DENIED** and it is **SO ORDERED.**

The Clerk is directed to transmit copies of this Order to the parties in interest.

ENTER: 8/21/01

s/ L. Edward Friend, II
U.S. Bankruptcy Judge